Republic of Georgia
Rating Report

BB
STABLE OUTLOOK

Credit strengths	Credit challenges
• Solid medium-run growth profile • Strong debt structure • Strengthened macroeconomic policy framework and record of constructive engagement with multilateral partners	• Heightened geopolitical risk • Risk due to domestic political instability • Elevated vulnerability to external shock(s) and reliance upon external financing • Elevated dollarisation

Rating rationale:

Strong growth outlook: After suffering from a sharp 2020 decline of economic output during the Covid-19 pandemic crisis, the Georgian economy has since recovered strongly. The economy benefits from strong medium-run economic growth potential, driven by recovery of private consumption, of tourism receipts and of investment. Foreign direct investment (FDI) is expected to edge back to pre-crisis levels and support economic growth.

Improved fiscal and macroeconomic policy frameworks: Georgia has established a strong track record of engagement with multilateral partners (such as with the IMF and the European Union), which has anchored a constructive reform agenda during the previous decade. We expect the government to remain committed to prudent policy making and fiscal discipline medium run.

Strong debt profile: Georgian public debt is largely owed to official-sector creditors, on concessional terms. This allows the government to benefit from comparatively long debt maturities, modest interest costs as well as reduced refinancing risk.

Rating challenges include: i) heightened geopolitical risk after Russia's escalation of conflict in Ukraine alongside risk from domestic political instability; ii) vulnerability to external shocks owing to the small size of the economy (nominal GDP of USD 20.9bn in 2022) alongside high reliance on external financing; iii) financial stability risk as associated with elevated dollarisation of the economy.

Georgia's sovereign rating drivers

Risk pillars		Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard	Final rating
		Weight	Indicative rating		Notches	
Domestic Economic Risk		35%	b		+1/3	
Public Finance Risk		25%	aa-		0	
External Economic Risk		10%	c		-2/3	
Financial Stability Risk		10%	a+		0	BB
ESG Risk	Environmental Risk	5%	aa		0	
	Social Risk	5%	bbb+		0	
	Governance Risk	10%	bb-		-1/3	
Overall outcome			**bb+**	**0**	**-1**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• Reduction of external-sector risk • Implementation of reforms enhances structural aspects of the economy • Improvement of fiscal sustainability	• Escalation of geopolitical risk • Deterioration in institutional quality • Increase in external vulnerabilities • Worsening of medium-run general government debt trajectory

Ratings and Outlook

Foreign currency

Long-term issuer rating	BB/Stable
Senior unsecured debt	BB/Stable
Short-term issuer rating	S-3/Stable

Local currency

Long-term issuer rating	BB/Stable
Senior unsecured debt	BB/Stable
Short-term issuer rating	S-3/Stable

Lead Analyst

Dennis Shen
+49 30 221823948
d.shen@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** The Covid-19 pandemic resulted in an output decline of 6.7% in 2020. Economic recovery supported annual growth of 10.4% last year. Growth continued to gather momentum in Q1 2022, even as the Russian full-scale invasion of Ukraine has posed far greater economic uncertainties for the economy at this stage, given strong economic links with Russia and Ukraine: the countries accounted for 22% of Georgian exports, 21% of remittances (mostly from Russia) and 25% of tourism inflows in 2021. We expect growth to remain strong this year at 8.5% before convergence on medium-run potential of 5% by 2023. Pent-up demand, strong export-sector performance and solid increases of tourism numbers and remittances support recovery. Robust medium-run growth potential is underpinned by capacity to draw FDI, especially in the financial, energy, hotels and restaurant sectors, and investment in public infrastructure works.

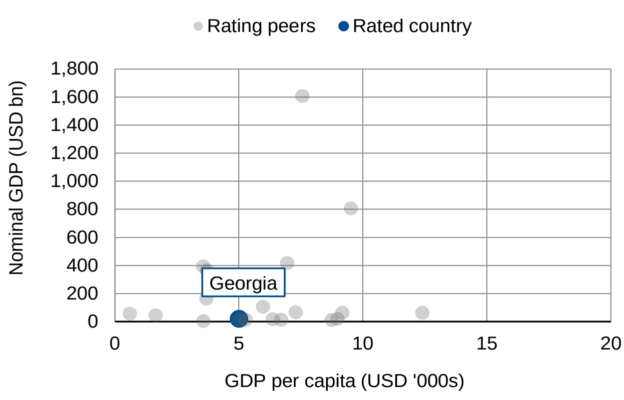
- **Inflation and monetary policy:** Headline inflation peaked at 13.9% YoY in January 2022. Inflation has eased slightly since to 12.8% YoY by June this year, still well above a National Bank of Georgia (NBG) 3% objective. The NBG expects inflation to average 9.6% over 2022, with this inflation rate starting to converge on its target rate as sharp rises in food and energy prices gradually dissipate. To counter price pressures, the NBG has raised its policy rate a cumulative 300bps to 11% by March 2022 and left rates unchanged since. The Georgian lari had appreciated significantly before the Ukraine war escalated. In late February to early March 2022, the currency depreciated against the US dollar, before recovering losses by May (currently +26% compared with April 2021 lows). High dollarisation and the predominantly fixed-rate structure of lending mitigates effectiveness of monetary-policy transmission.

- **Labour markets:** Unemployment rose during the Covid-19 crisis, averaging 20.6% over year 2021. Due to economic recovery, the unemployment rate decreased to 19.4% by Q1 2022 and we expect unemployment to average 18.1% this year before averaging 17.6% in 2023. The informal sector of the labour market was decreased in 2020, accounting for circa 31% of aggregate employed in the year as compared with 51% in 2019, after changes of labour legislation and workers registering for formal employment during the Covid-19 crisis.

Overview of Scope's qualitative assessments for Georgia's *Domestic Economic Risks*

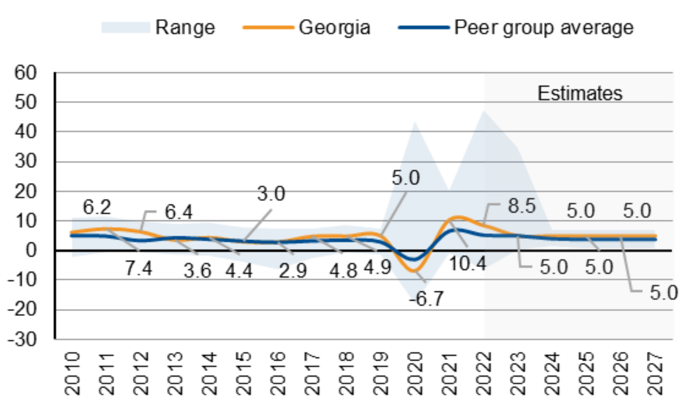
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Growth potential of the economy	Strong	+1/3	Strong medium-term growth potential of circa 5% annually
	Monetary policy framework	Neutral	0	Strengthened monetary policy framework, pre-pandemic track record of managed inflation, adequate monetary-policy response to higher inflation, but policy flexibility curtailed by dollarisation
	Macro-economic stability and sustainability	Neutral	0	Strong FDI and domestic investment, but limited diversification, small, open economy, low domestic savings, high unemployment, and labour force concentration in low-productivity sectors

Nominal GDP and GDP per capita, USD '000s



Source: IMF, Scope Ratings GmbH

Real GDP growth, %



Source: IMF, Scope Ratings GmbH

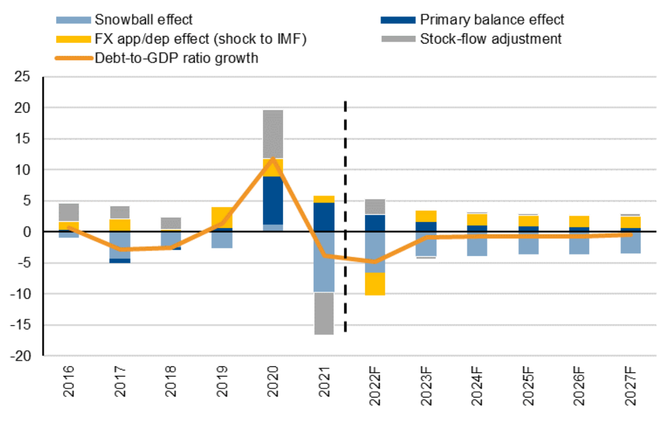
Public Finance Risks

- **Fiscal outlook:** Before the Covid-19 crisis, Georgia recorded modest budget deficits (1.2% of GDP on average over 2015-19). The headline budget balance deteriorated to -9.3% of GDP in 2020 before recovering to -6.0% of GDP by 2021. The 2021 deficit was mainly financed via a large precautionary stock of government deposits as well as through donor and international financial institution (IFI) financing. Data point towards recovery of compliance with national fiscal rules by 2023 – such as a 3% of GDP national deficit rule, after suspension of said rules in 2020. A 0.2% of GDP budgetary increase that the government intends to introduce to mitigate impact of higher energy and food prices for vulnerable households will not affect the deficit. The fiscal impact of the Russia-Ukraine crisis more generically is expected to be comparatively small, as the positive impact of higher inflation on revenue largely offsets the impact from lower growth and additional targeted support provided to vulnerable households.
- **Debt trajectory:** The general government debt-to-GDP ratio increased 20pps from 40.4% in 2019 to 60.2% in 2020. It then decreased to 49.5% of GDP by end-2021, supported by the economic rebound and improvement of the budget balance. We expect the debt ratio to decline to 44.7% in 2022 and to 41.2% by 2027, supported by strong nominal economic growth and commitment to fiscal prudence, although weakened by assumed structural depreciation of the currency of 6% yearly over 2023-27 against the US dollar.
- **Debt profile and market access:** Around 80% of Georgian public debt is denominated in foreign currency, resulting in debt dynamics being vulnerable to volatility of the exchange rate. This vulnerability, however, is mitigated by nearly three-quarters of government debt on concessional interest-rate terms, curtailing debt-sustainability risk. Further strengths of the government debt profile incorporate a large share of long-term debt, accounting for nearly 99% of aggregate debt. The debt management strategy outlined by the Ministry of Finance for 2022 aims to deepen the domestic capital market and reduce the share of FX-denominated debt over the medium run. The single USD 500m sovereign Eurobond outstanding was rolled over in April 2021 at an historically low coupon rate of 2.75% with a new five-year bond.

Overview of Scope's qualitative assessments for Georgia's *Public Finance Risks*

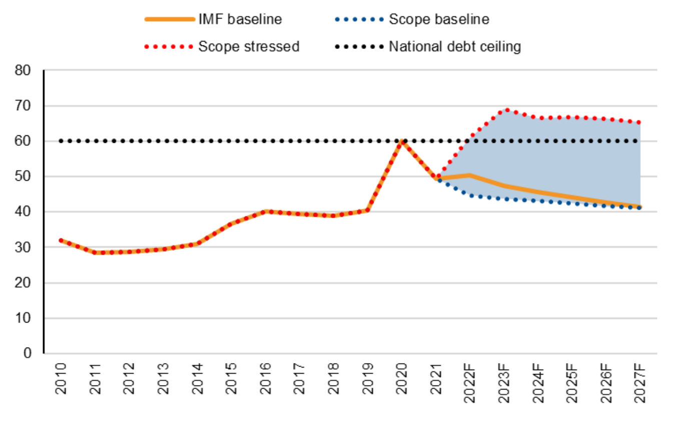
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Track record of pre-pandemic contained fiscal deficits and fiscal prudence underpinned by successful engagement with the IMF; expectation of moderating deficits moving ahead
	Debt sustainability	Neutral	0	Expected stabilisation in debt levels over medium run, but debt trajectory exposed to significant exchange-rate risk
	Debt profile and market access	Neutral	0	More than two-thirds of debt owed to official donors on concessional terms; track record of sound access to concessional financing

Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

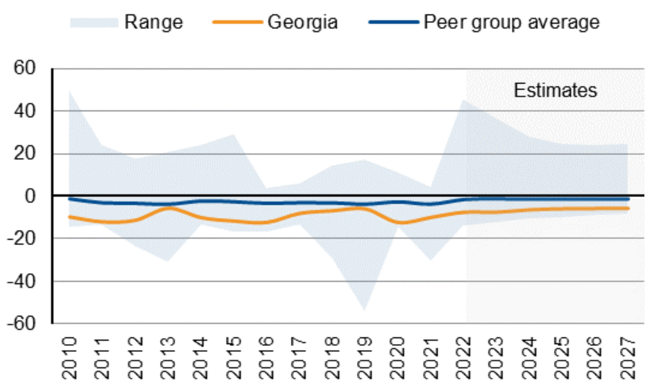
External Economic Risks

- **Current account:** Georgia displays wide, structural current-account deficits, although some improvements were observed in said deficits in years before the Covid-19 crisis, when the deficit shrunk to 5.9% of GDP in 2019 from 12.5% of GDP as of 2016. The deficit widened in 2020, when a freeze of international travel caused the current-account balance to reverse sharply to -12.5% of GDP. The current account thereafter improved in 2021 to 10% of GDP, supported by recovery of goods exports and international tourism services. Stronger tourism services exports, strong growth of remittances (+65% YoY in 1H-22 after arrivals of Russians, Belarusians and Ukrainians) and strengthened competitiveness via past exchange-rate depreciation have strengthened the current account in 2022 despite the rise of oil prices. The current-account deficit is expected to moderate to 7.5% of GDP in 2022.
- **External position:** Recurrent current-account deficits have brought an elevated net external liability position (net international investment position of circa -132% of GDP as of Q1 2022). The external position's composition is, however, stable, with more than half of external liabilities being in form of foreign direct investment and only a small share of portfolio investment. External debt increased over 2020 and amounted to 136% of GDP by Q1 2021, although most of this debt was long-term and borrowed from IFIs on concessional conditions. Foreign debt gradually declined over 2021, reaching 111% of GDP by Q1 2022. IMF projections see external debt continuing to decline to circa 60% of GDP by 2027, reflecting lesser external financing requirements and government initiative(s) to reduce external borrowing. The weighted average maturity of external public debt is above eight years.
- **Resilience to short-term external shocks:** Georgia's small, open economy is vulnerable to external shock and reliant upon external financing. High dollarisation and an elevated share of foreign-currency-denominated public debt represent risks during phases of lari volatility. Such risks are partially offset by an enhanced stock of official reserves, of USD 3.9bn in June 2022 (20% of GDP), slightly under a USD 4.3bn peak reached at the end of 2021 due to selling of forex to defend lari. A new USD 280m IMF Stand-By Arrangement was agreed upon in June, providing support for economic policies over the next three years, with USD 40m immediately available (although said programme is expected to be treated on precautionary basis).

Overview of Scope's qualitative assessments for Georgia's *External Economic Risks*

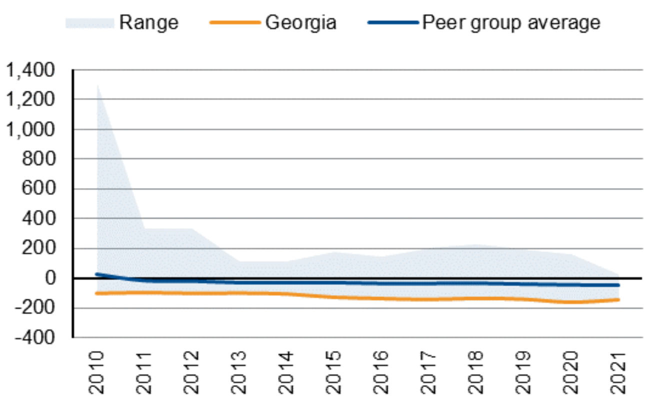
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
c	Current account resilience	Weak	-1/3	Wide structural current-account deficits, high reliance on tourism-sector revenue and remittances inflows, but significant FDI inflow
	External debt structure	Neutral	0	Large net international liability position mitigated by a sound record of concessional donor financing
	Resilience to short-term shocks	Weak	-1/3	Dollarisation, significant external financing requirements and elevated exchange-rate volatility weigh upon external-sector resilience

Current-account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings GmbH

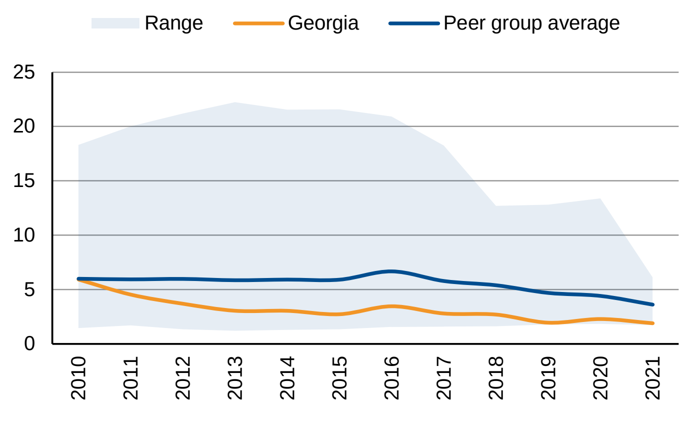
Financial Stability Risks

- **Banking sector:** The banking sector has weathered the pandemic crisis comparatively well. The tier 1 capital ratio improved during 2021 and reached 16.2% of risk-weighted assets by Q1 2022, above an end-2019 level of 14.6% and after decline during early 2020 (to lows of 11.8% in Q1 2020). Liquidity is adequate (liquidity coverage ratio of 118% as of April 2022, above a 100% minimum requirement). The non-performing loan (NPL) ratio (NBG definition) rose in 2021, reaching 8.3% in March 2021, with the gradual phase out of Covid-19 support programmes and loan moratoria, triggering declines of household creditworthiness. However, on the back of robust credit growth, stable real estate prices and lari appreciation, the NPL ratio decreased to 5% by March 2022. Restructured loans have as well dropped from 21.2% in February 2021 to 15.3% by March this year. Profitability, as measured via return on equity, has recovered, averaging 30.9% over 2021, before moderating to 20.8% in Q1 2022.
- **Private debt:** Credit growth accelerated during the pandemic crisis and has remained robust since 2021, despite monetary policy tightening, with the former standing at 11.5% YoY as of July 2022, mainly driven by local-currency lending (20.9% YoY). Household indebtedness is moderate, having nevertheless increased since the pandemic crisis due to strong credit growth and revaluations after lari depreciation against the US dollar, bringing the debt burden to 41.3% of GDP as of Q2 2021, 3.7pps above that from Q2 2020. An increase of loan maturities, however, helped stabilise the household debt service-to-income ratio around 12%.
- **Financial imbalances:** Dollarisation has, importantly, decreased moderately, with 53.9% of loans and 59.2% of deposits denominated in foreign currency as of July 2022, from 64.8% and 64.4% as of end-2019. Banks are incentivised to reduce FX liabilities via lower reserve requirements in exchange for lower deposit dollarisation. High dollarisation, especially evident in the funding structures of non-financial corporates less constrained by the high minimum size required for forex bank lending, constitutes a significant vulnerability nevertheless with respect to financial stability, all the more under a context of high inflation. Some overheating risks are, moreover, evident in the property sector, with major (sale and rental) price rises.

Overview of Scope's qualitative assessments for Georgia's *Financial Stability Risks*

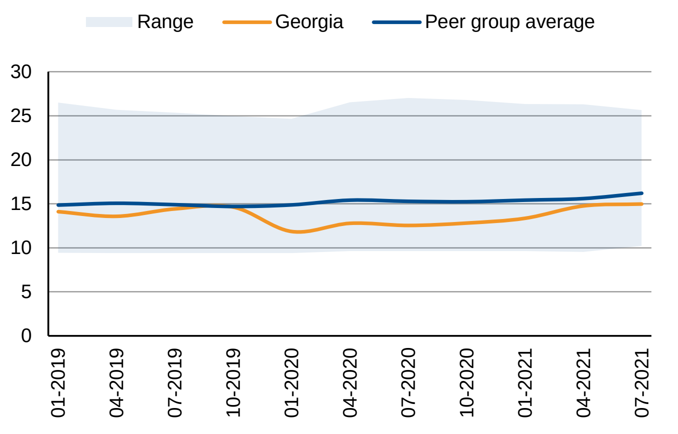
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Banking sector performance	Neutral	0	Adequate liquidity and capitalisation of the banking system with improvements of asset quality and profitability
	Banking sector oversight	Neutral	0	Strengthened financial supervision and regulatory framework including via application of IMF Financial Sector Assessment Program guidance
	Financial imbalances	Neutral	0	Elevated dollarisation with more than half of banking-system loans and deposits in foreign currency – although dollarisation has moderately declined

NPLs, % of total loans



Source: World Bank, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

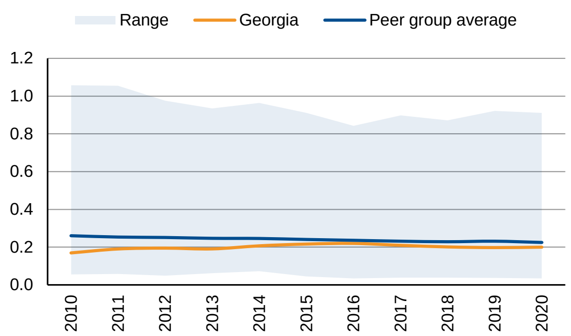
ESG Risks

- **Environment:** Georgia is exposed to substantive environmental risk, associated with elevated air pollution in main cities, illegal logging as well as cattle grazing within protected areas. This is partially mitigated by coordinated policy countermeasures such as reductions of air pollution and carbon emissions and the setting up of legislation and enforcement around waste management. CO_2 emissions intensity is moderate. However, the supply of energy remains predominantly imported, with natural gas and oil products making up more than two third of energy supply – with most such natural gas coming from Azerbaijan. The 2030 climate change strategy aims for reducing greenhouse gas emissions to 35% under 1990 levels for key sectors.
- **Social:** High structural unemployment and a weak social safety net represent significant longer-run challenges. The poverty ratio declined to 17.5% in 2021, after an increase to 21.3% in 2020. Net emigration has resulted in the working-age population declining circa 0.8% a year over a past decade (furthermore anticipated to drop circa 0.6% a year on average over 2022-27), weighing on the longer-run economic outlook. Up to 90,000 Russians, Belarusians and Ukrainians have relocated to Georgia since escalation of the war in the Ukraine. This represents, at least short run, a boost for the labour market.
- **Governance:** Divisions have stayed elevated between ruling centre-left Georgian Dream and largest opposition group United National Movement in aftermath of a severe political crisis that followed 2020 parliamentary elections. Compared to an historical record of EU-oriented reform, Georgia has recently observed democratic backsliding. While Ukraine and Moldova were granted candidate status for EU accession in June 2022, Georgia was granted a "European perspective" – e.g., candidacy only upon meeting specified institutional and governance targets. The Georgian Dream government did not immediately participate in western sanctions, treading carefully as not to aggravate Russia. However, authorities have more recently implemented sanctions on Russia, overseen change of ownership of one major Russian-owned bank and taken control of a large mineral water producer. Above 80% of the population supports EU membership. Outside of Ukraine, we consider Georgia as the most geopolitically at-risk country of our rated sovereign universe to Russian aggression – challenging the long-run credit outlook. This includes risk surrounding separatist territories of South Ossetia and Abkhazia.

Overview of Scope's qualitative assessments for Georgia's *ESG Risks*

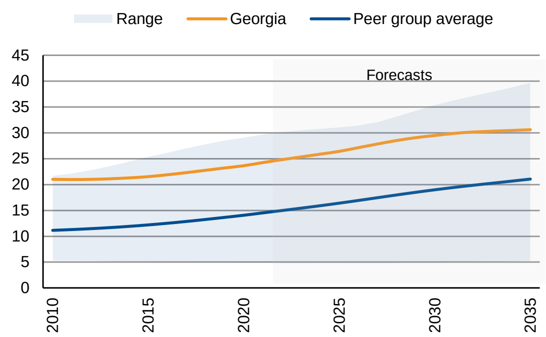
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb-	Environmental risks	Neutral	0	Substantive environmental risk such as with relation to air pollution, but mitigated by coordinated policy countermeasures
	Social risks	Neutral	0	High, although gradually declining, rates of poverty, skills mismatches, adverse demographics, high unemployment
	Institutional and political risks	Weak	-1/3	Track record of significant improvement in governance as well as in quality and effectiveness of public administration, but domestic political instability as well as elevated geopolitical risk after Russia's escalation of conflict in the Ukraine

CO_2 emissions per GDP, $mtCO_2e$



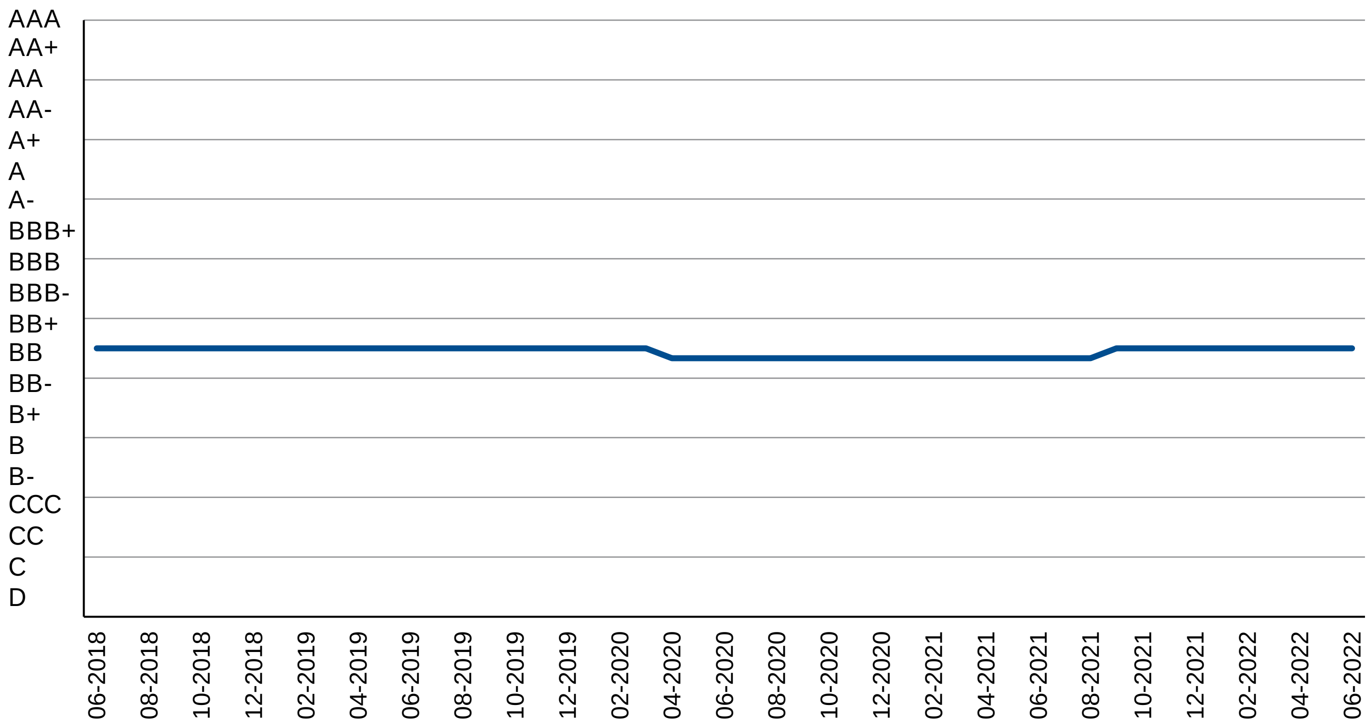
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Serbia
Turkey

Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
Domestic Economic Risk								
GDP per capita, USD '000s	4.1	4.4	4.7	4.7	4.3	5.0	5.6	6.3
Nominal GDP, USD bn	15.1	16.2	17.6	17.5	15.8	18.7	20.9	23.3
Real growth, %[1]	2.9	4.8	4.8	5.0	-6.8	10.4	8.5	5.0
CPI inflation, %	2.1	6.0	2.6	4.9	5.2	9.6	9.9	5.1
Unemployment rate, %[1]	21.7	21.6	19.2	17.6	18.5	20.3	18.1	17.6
Public Finance Risk								
Public debt, % of GDP[1]	40.3	39.4	38.9	40.4	60.2	49.5	44.7	43.7
Interest payment, % of government revenue	4.2	4.4	4.4	4.6	6.2	5.2	4.5	4.5
Primary balance, % of GDP[1]	-0.4	0.7	0.4	-0.6	-7.7	-4.7	-2.8	-1.6
External Economic Risk								
Current-account balance, % of GDP[1]	-12.5	-8.0	-6.8	-5.9	-12.5	-10.0	-7.5	-7.5
Total reserves, months of imports	3.3	3.2	3.1	3.2	4.4	-	-	-
NIIP, % of GDP	-132.9	-139.4	-131.4	-137.5	-158.0	-141.3	-	-
Financial Stability Risk								
NPL ratio, % of total loans	3.4	2.8	2.7	1.9	2.3	1.9	-	-
Tier 1 ratio, % of risk-weighted assets	9.9	11.6	13.5	14.6	12.8	15.6	16.2	-
Credit to private sector, % of GDP	58.7	58.1	62.6	67.7	79.9	-	-	-
ESG Risk								
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	219.5	209.4	200.8	197.3	199.6	-	-	-
Income quintile share ratio (S80/S20), x	6.5	7.1	6.6	6.3	5.9	-	-	-
Labour-force participation rate, %	74.3	72.7	70.3	69.4	-	-	-	-
Old-age dependency ratio, %	21.9	22.3	22.8	23.2	23.6	24.2	24.8	25.3
Composite governance indicator[2]	0.4	0.4	0.4	0.4	0.4	-	-	-

[1] Forecasted values are produced by Scope
[2] Average of the six World Bank Worldwide Governance Indicators
Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

Appendix IV. Economic development and default indicators

IMF Development Classification — Emerging Market and Developing Economies

5y USD CDS spread (bps)

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 Avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 8295 8254

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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